Venture capital Southeast Asia

Plenty of fish in the S.E.A

Private market insights

welcome to brighter

An attractive segment

We believe Southeast Asian venture capital (VC) is an attractive segment within the Asia private equity market, and clients should consider developing relationships with Southeast Asian VC managers.

The VC market in this region is receiving increasing interest from investors for the following reasons:

- Large and young population that is increasingly affluent and digital-savvy
- Around five to eight years behind China and following similar digital growth trends
- Developing innovation ecosystem
- Broadening exit avenues

Armed with significant dry powder and an increasing investment opportunity set, VC funds should be active for the next few years.

In this article, we describe the overall environment in Southeast Asia and the VC ecosystem and present recent themes and opportunities for you to consider. Despite its challenges, we view Southeast Asia as an increasingly attractive market for VC that is becoming hard to ignore.

A region on the rise

Southeast Asia has a combined GDP of US$3.2 trillion,[1] the fifth-largest economy in the world behind the US, China, Japan and Germany — yet it only received 6% of global venture investments in 2019.[2] If the countries of Southeast Asia were one nation, it would have the world's third-largest population, with approximately 655 million people. The region is also relatively young, with a median age of 30.2 years,[3] and comparatively unburdened by the challenges of rapidly aging populations currently plaguing China, Japan and South Korea. Southeast Asia had been delivering predictable and healthy GDP growth of approximately 5%[4] p.a. in the past two decades and is expected to grow 6.4% in 2021.

However, the region is very diverse. Spread across 10 countries only loosely tied together via the Association of Southeast Asian Nations (ASEAN)[5], the region is home to more than a dozen languages, and each country has its own political, legal and economic system; culture; use of technology; education; population age and religion. Indonesia, for example, is almost 90% Muslim, whereas Thailand is more than 95% Buddhist and the Philippines more than 80% Roman Catholic.[6] The 10 countries are also at different economic stages, with GDP per capita (2019) ranging from US$65,233 in Singapore to US$1,408 in Myanmar.[7]

The largest economies by GDP are Indonesia, Thailand, the Philippines, Singapore, Malaysia and Vietnam, which collectively account for 96% of the region's total GDP. The fastest-growing economies are Vietnam, the Philippines and Indonesia, with 2019 GDP growth of 7%, 6% and 5%,[8] respectively.

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[1] The World Bank, as of October 2020 for the period of 2019.

[2] AVCJ Database for 2019.

[3] United Nations Department of Economic and Social Affairs as of November 2020.

[4] ASEAN+6 economies (Indonesia, Singapore, Malaysia, Thailand, Vietnam and the Philippines) from 2000 to 2018.

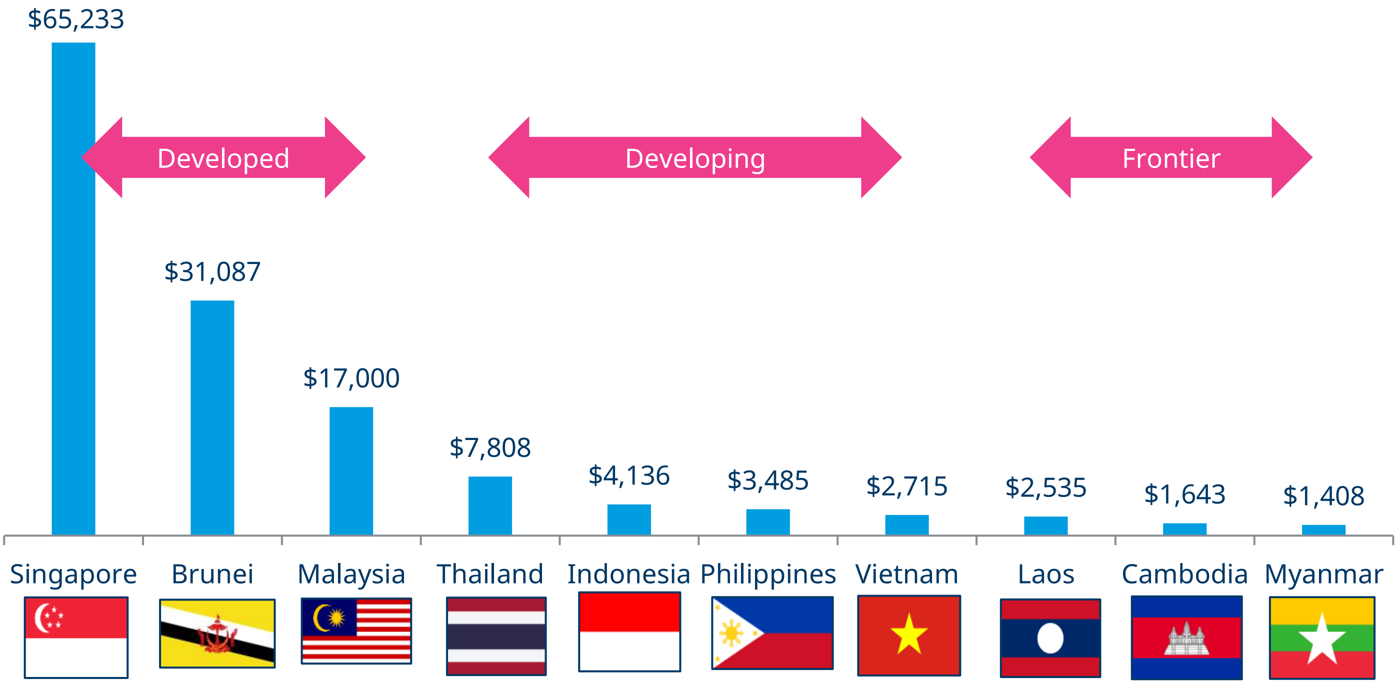
[5] ASEAN is a loose regional multilateral framework through which member states cooperate in economic, political-security and sociocultural matters without undermining member nations' own agency and independence, a desire arising from colonial history and the experience of the 1997–1998 Asian crisis. Its contributions to trade integration and political and legal harmonization are therefore limited.

[6] World Economic Forum. "7 Surprising Things You Probably Don't Know About ASEAN," 2016, available at www.weforum.org/agenda/2016/05/7-surprising-things-about-asean.

[7] International Monetary Fund. *World Economic Outlook*, September 2020.

[8] The World Bank, as of October 2020 for 2019.

Figure 1. GDP per capita (2019)



Source: IMF World Economist as of September 2020

Young, affluent and tech-savvy

Southeast Asia's internet penetration rates have already overtaken China, and more than 90% of internet users connect using their mobile devices.

Driven by a sizeable young population that is increasingly affluent and tech-savvy, digital adoption in Southeast Asia has grown rapidly, reaching 400 million or nearly 70% of the population. This happened five years faster than initially projected by a 2019 study.[9] The COVID-19 pandemic has further accelerated the digitalization trend, causing as many as 40 million people to come online for the first time in 2020.[10]

The population is also highly connected, with mobile subscriptions at 141% of the total population (compared to the global average of 118%[11]), demonstrating the region's infrastructure capabilities and digital readiness. Consumer online spending is taking off, as evidenced by the growth in e-commerce gross merchandise value (GMV), expected to reach US$300 billion by 2025 and growing at a compound annual growth rate of 33% since 2015.[12]

The GMV is largely driven by the increasing number of middle-class households in the region. These households are anticipated to hit 120 million by 2025, almost double the number in 2010.[13] Overall, Southeast Asia is estimated to be five to eight years behind China and is expected to follow similar digital-growth trends as the region's GDP per capita reaches the level at which consumer consumption begins to dominate.

A young but maturing venture capital ecosystem

Southeast Asia's innovation ecosystem is showing signs of becoming the next big economy for VC. Government grants, incubators, accelerators, universities and a growing pool of angel investors and talented entrepreneurs have accelerated the number of startups and seed investments. Some of these companies have expanded domestically and some regionally, with many raising consecutive rounds of funding.

Singapore is the startup hub for the region, thanks to strong government support. Other regional governments are following suit, with digital-first policies such as Thailand 4.0, Malaysia 5.0, Indonesia's Nexicorn, Vietnam's National Digital Transformation Programme and the Philippines' Digital Transformation Strategy. Some governments are even attempting to mitigate the downturn caused by COVID-19. The Singaporean government has offered around US$213 million to finance "promising" startups.14 The program will allow those startups to sustain their innovation and commercialization activities in various sectors.

Strategic interests have broadened the exit avenues for startups and investors. Regional tech giants such as Grab, Gojek, SEA, Lazada, Tokopedia, Traveloka, Bukalapak and Razer are becoming acquirers to expand their market reach or product range. Gojek acquired seven startups in the region between 2017

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[9] Facebook and Bain & Company. *Riding the Digital Wave: Capturing Southeast Asia's Digital Consumer in the Discovery Generation*, January 14, 2020, available at www.bain.com/insights/riding-the-digital-wave.

[10] Bain & Company, Google, Temasek. "e-Conomy SEA 2020,"available at www.bain.com/insights/e-conomy-sea-2020.

[11] Bain & Company, Google, Temasek. "e-Conomy SEA 2019,"available at www.bain.com/insights/e-conomy-sea-2019.

[12] Ibid.

[13] Martin K. "Southeast Asia's Rising Wealth," 2018, available at www.hsbc.com/insight/topics/southeast-asias-rising-wealth.

[14] Enterprise Singapore, a statutory board under the Ministry of Trade and Industry, announced June 5, 2020.

and 2019; Grab has acquired nearly 40 smaller startups since inception. The table below shows the number of acquisitions by regional unicorns from the year they became a unicorn.

Figure 2. Number of acquisitions by regional unicorns

Unicorn	Year became unicorn	No. of acquisitions	Latest valuation (USD bn)	Status
Go-Jek	2018	11	$10.0	Private
Trax	2019	4	$1.3	Private
Razer	2015	4	$3.1	HKSE
Traveloka	2017	3	$3.0	Private
Grab	2018	2	$14.3	Private
Sea	2015	1	$89.0	NYSE
Tokopedia	2018	1	$7.0	Private
Bukalapak	2017	1	$3.5	Private
Lazada	2014	1	$3.2	Private

Source: "Southeast Asia Exit Landscape: A New Frontier," CBInsights, November 30, 2020.

Southeast Asia VC has also gathered interest from established regional conglomerates, state-owned enterprises and tech giants from China. The Chinese tech giants tend to adopt a more aggressive buy-and-build strategy and have long seen Southeast Asia as a natural region for expansion. Given worsening relations between China and the US, Southeast Asia has become an increasingly attractive region with its high growth and proximity to China. This is borne out by Alibaba's investment in Lazada and Tencent's stake in Shopee's parent company, SEA. Likewise, US tech giants are attracted by the rise of Southeast Asia's internet economy and its favorable demographics for growth. US tech companies have made high-profile investments in Indonesian e-commerce platforms, including Google's financing participation in Tokopedia and Microsoft's participation in Bukalapak funding.

Given the region's startup growth, the presence of global private equity managers and corporate VC participation as late-stage investors is also growing. Companies have been looking at VC as a way to gain a strategic edge. Toyota's investment of US$1 billion in Grab's Series H financing round represents the largest-ever global investment by an automotive manufacturer in the region.

At this point, exit options for startups are more limited compared to the US and China. Southeast Asia has not seen many tech IPOs to date — unlike China, where IPOs are the dominant exit route — and many exit strategies center around M&A. Secondaries are also becoming a significant exit route for smaller, early-stage funds as companies seek to clean up their capitalization tables as they grow bigger and key shareholders take a bigger stake. However, with increasing capital inflow and validation of the market, the region will start to witness more companies pursuing IPOs. Regional and global stock exchanges are also providing support to facilitate and accommodate increased listings of Southeast Asian startups through less-stringent listing requirements.

Recent themes and attractive opportunities

Although COVID-19 has slowed the global economy, it has accelerated digital transformation globally, including in Southeast Asia. Consumers are forming new habits, such as a preference for online interaction, which will likely continue long term. These behavioral changes provide strong tailwinds to sectors such as healthtech, online education, smart logistics and fintech. Cash transactions were outpaced by mobile and digital payments for the first time during this period.

Shifts may occur, especially as the pandemic highlights the importance of accessible healthcare and more players enter the market. Governments may become more supportive of incorporating new technological platforms to supply additional healthcare services. Funding in the region for healthtech investments is concentrated in Singapore and Indonesia. Halodoc, an Indonesian telemedicine platform, has relieved the pressure on healthcare delivery by addressing the surge in demand caused by the pandemic. These technologies can service up to 80% of patients at home.[15] Technology allows healthcare resources to be scaled rapidly and efficiently in a region with a fast-growing population and one of the world's lowest healthcare professional ratios.

The healthcare industry generally faces significant government regulatory hurdles and involves integration with many offline elements, such as doctors, hospitals and pharmacies, limiting regional expansion for Southeast Asian startups in this sector.

Fintech is another attractive sector in Southeast Asia. Government regulations are becoming more supportive of financial services as governments improve financial inclusion. More than 70% of Southeast Asia's population is either underbanked or unbanked,[16] so digital financial services have plenty of room to grow. Digital payments in the region are expected to exceed US$1 trillion by 2025 [16] and fintech is the largest sector backed by VC by number of startups.

Indonesia, Singapore and Vietnam are considered the most attractive immediate opportunities due to their booming internet economies, high and rising internet penetration rates, and increasing VC investment. In Indonesia, the younger generations, which make up the majority of the population, are driving adoption of alternative lending and digital wallets. Digital-wallet transactions surged 173% in 2019.[17] In Singapore, artificial intelligence fintech and blockchain startups received the most funding in 2019. In Vietnam, digital payments have grown rapidly with the help of government support and a booming e-commerce sector.

[15] Rayda N. "More Demand for Telemedicine as Indonesians Stay Away From Hospitals Amid COVID-19", *CNA*, 2020, available at www.channelnewsasia.com/news/asia/indonesia-covid-19-telemedicine-halodoc-alodokter-demand-rises-12829088.

[16] Bain & Company, Google and Temasek, "The Future of Southeast Asia's Digital Financial Services," 2019, available at www.bain.com/insights/fufilling-its-promise.

[17] "E-Money Transactions in Indonesia Skyrocket 173% in January," *The Jakarta Post*, 2020, available at www.thejakartapost.com/news/2020/02/27/e-money-transactions-in-indonesia-skyrocket-173-in-january.html.

Challenges of the Southeast Asian market

The diversity of Southeast Asia makes it both unique and challenging. Startups that have succeeded in one country may struggle to replicate that success in another due to cultural and language barriers as well as differing legal and regulatory environments. Startups cannot apply a one-size-fits-all strategy; instead, they must forge partnerships with established local players to succeed. Compared to the large homogeneous markets of the US and China, the fragmentation in Southeast Asia is more akin to that of Africa and Latin America.

Southeast Asia is home to a few fairly advanced economies and many up-and-coming ones, such as Cambodia and Myanmar and parts of Vietnam, Thailand, and Indonesia. These countries may face challenges, such as corruption, a lack of proper infrastructure, a heterogeneous regulatory environment and a limited talent pools. Foreign investors should also remember that these countries do not often provide a strong legal framework to protect investor capital. Successful startups tend to anchor themselves in a local market before selectively expanding their businesses in the region.

Although Southeast Asia has a shortage of talent, alumni from overseas universities and tech giants are being lured back to key markets in the region. Employees of the region’s tech giants are increasingly leaving to start their own ventures, bringing with them a track record of building companies from the ground up and the know-how to navigate this complex region.

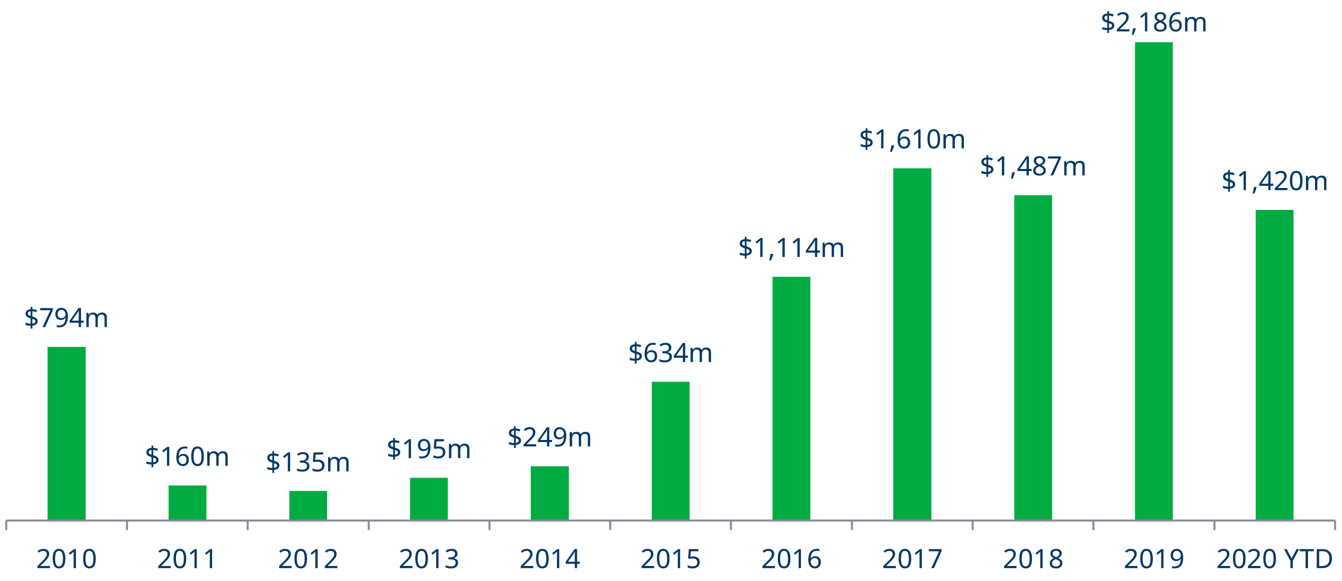
Venture capital funds

Competition is increasing as large international VC fund managers focus on the region. In addition, several established local firms have larger funds, and a handful of emerging managers specialize in the region. Competition is concentrated in the earlier stages, with noticeably fewer players in Series B and Series C financing rounds, creating a funding gap.

By invested amount, global VC funds dominate the market, as they have large amounts of capital to deploy and tend to invest in large ticket sizes in later-stage rounds (Series B onwards). By number of investments, local VC funds that target earlier-stage rounds tend to be more active.

Fundraising by VC funds in the region has been increasing rapidly since 2015, peaking in 2019 with a record US$2.2 billion of capital raised. Given the impact of COVID-19, fundraising in 2020 (year-to-date through October 28) has been fairly strong, demonstrating the attractiveness of this region despite the ongoing pandemic.

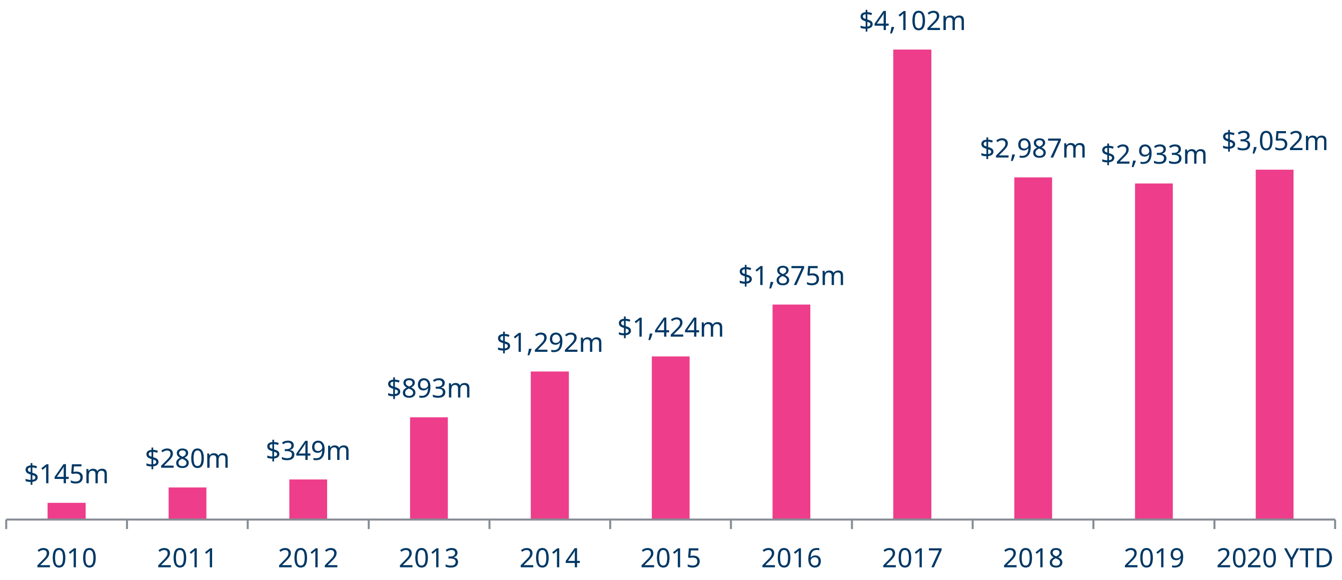
Figure 3. Fundraising by SEA-based venture capital fund



Source: AVCJ as of October 28, 2020.

Investments in Southeast Asian startups have also spiked in the past four years, with the majority of the capital invested in Singapore and the second-highest investments in Indonesia. Vietnam only started receiving meaningful investment in 2018, so it still lags well behind Singapore and Indonesia.

Figure 4. Venture capital intervention (all stages)



Source: AVCJ as of October 28, 2020

Conclusion

Compared to other major VC markets like the US and China, Southeast Asia's ecosystem is much more nascent. Apart from not having a single, large, homogeneous domestic market, tech and startup talent is in short supply, inhibiting faster growth. In addition, the ecosystem needs further development in terms of follow-on investors and exit options. Despite the challenges and nuances of the region, Southeast Asia is an increasingly attractive market, with strong growth potential for an investor comfortable with the regional idiosyncrasies and with the appropriate risk tolerance.

We believe manager access is critical in VC. Based on recent trends in Southeast Asia, now is the time to start developing relationships with managers that could tap into this attractive growth market. Missing out now could create access issues later, as is the case for many US and Chinese VC funds.

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